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DEPARTMENT OF THE TREASURY

31 CFR Part 103

RIN 1506-AA37

Financial Crimes Enforcement Network; Amendment to the Bank Secrecy Act Regulations – Requirement That Mutual Funds Report Suspicious Transactions

AGENCY: Financial Crimes Enforcement Network ("FinCEN"), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains an amendment to the regulations implementing the statute generally known as the Bank Secrecy Act. The amendment would require mutual funds to report suspicious transactions to the Department of the Treasury. The amendment constitutes a further step in the creation of a comprehensive system for the reporting of suspicious transactions by the major categories of financial institutions operating in the United States, as a part of the counter-money laundering program of the Department of the Treasury.

DATES: Written comments on all aspects of the notice of proposed rulemaking are welcome and must be received on or before [INSERT DATE THAT IS 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

ADDRESSES: Commenters are encouraged to submit comments by electronic mail because paper mail in the Washington, DC, area may be delayed. Comments submitted by electronic mail may be sent to regcomments@fincen.treas.gov, with the caption, in the body of the text, "ATTN: NPRM – Suspicious Transaction Reporting – Mutual Funds." Comments also may be submitted by paper mail to FinCEN, P.O. Box 39, Vienna, Virginia 22183-0039, ATTN: NPRM – Suspicious Transaction Reporting – Mutual

Funds. Comments should be sent by one method only. For additional instructions on the submission of comments, see **SUPPLEMENTARY INFORMATION** under the heading "Submission of Comments."

FOR FURTHER INFORMATION CONTACT: Office of Regulatory Programs, FinCEN, (202) 354-6400; and Office of Chief Counsel, FinCEN, at (703) 905-3590 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

I. Background

A. Statutory Provisions

The Bank Secrecy Act[1] authorizes the Secretary of the Treasury, inter alia, to issue regulations requiring financial institutions to keep records and file reports that are determined to have a high degree of usefulness in criminal, tax, and regulatory matters, or in the conduct of intelligence or counter-intelligence activities, to protect against international terrorism, and to implement counter-money laundering programs and compliance procedures.[2] Regulations implementing Title II of the Bank Secrecy Act (codified at 31 U.S.C. 5311-5330) appear at 31 CFR Part 103. The authority of the Secretary to administer the Bank Secrecy Act has been delegated to the Director of FinCEN.

[1] Public Law 91-508, as amended, codified at 12 U.S.C. 1829b, 12 U.S.C. 1951-1959, and 31 U.S.C. 5311-5331.

[2] Language expanding the scope of the Bank Secrecy Act to intelligence or counter-intelligence activities to protect against international terrorism was added by section 358 of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT Act) Act of 2001 (the "USA Patriot Act"), Public Law 107-56.

With the enactment of 31 U.S.C. 5318(g) in 1992,[3] Congress authorized the Secretary of the Treasury to require financial institutions to report suspicious transactions. As amended by the USA Patriot Act, subsection (g)(1) states generally:

> The Secretary may require any financial institution, and any director, officer, employee, or agent of any financial institution, to report any suspicious transaction relevant to a possible violation of law or regulation.

Subsection (g)(2)(A) provides further:

> If a financial institution or any director, officer, employee, or agent of any financial institution, voluntarily or pursuant to this section or any other authority, reports a suspicious transaction to a government agency –
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> (i) the financial institution, director, officer, employee, or agent may not notify any person involved in the transaction that the transaction has been reported; and
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> (ii) no officer or employee of the Federal Government or of any State, local, tribal, or territorial government within the United States, who has any knowledge that such report was made may disclose to any person involved in the transaction that the transaction has been reported, other than as necessary to fulfill the official duties of such officer or employee.

Subsection (g)(3)(A) provides that neither a financial institution, nor any director, officer, employee, or agent of any financial institution

> That makes a voluntary disclosure of any possible violation of law or regulation to a government agency or a makes a disclosure pursuant to this subsection or any other authority … shall … be liable to any person under any law or regulation of the United States or any constitution, law or regulation of any State or political subdivision of any State, or under any contract or other legally enforceable agreement (including any arbitration agreement), for such disclosure or for any failure to provide notice of such disclosure to the person who is the subject of such disclosure or any other person identified in the disclosure.

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[3] 31 U.S.C. 5318(g) was added to the Bank Secrecy Act by section 1517 of the Annunzio-Wylie Anti-Money Laundering Act (the "Annunzio-Wylie Anti-Money Laundering Act"), Title XV of the Housing and Community Development Act of 1992, Public Law 102-550; it was expanded by section 403 of the Money Laundering Suppression Act of Title IV of the Riegle Community Development and Regulatory Improvement Act of 1994, Public Law 103-325, to require designation of a single government recipient for reports of suspicious transactions.

Finally, subsection (g)(4) requires the Secretary of the Treasury, "to the extent practicable and appropriate," to designate "a single officer or agency of the United States to whom such reports shall be made."[4] The designated agency is in turn responsible for referring any report of a suspicious transaction to "any appropriate law enforcement, supervisory agency, or United States intelligence agency for use in the conduct of intelligence or counterintelligence activities, including analysis, to protect against international terrorism."[5]

B. Overview of Mutual Funds

The application of the proposed rule would be limited to investment companies that are "mutual funds," which are open-end management investment companies as described in the Investment Company Act. Mutual funds are by far the predominant type of investment company. In 2001, approximately $7 trillion was invested in U.S. mutual funds, representing more than 95 percent of the assets held by investment companies regulated by the Securities and Exchange Commission ("SEC").[6] Currently, more than 3000 active mutual funds are registered with the SEC.[7]

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[4] This designation does not preclude the authority of supervisory agencies to require financial institutions to submit other reports to the same agency or another agency "pursuant to any applicable provision of law." 31 U.S.C. 5318(g)(4)(C).

[5] 31 U.S.C. 5318(g)(4)(B).

[6] The staff of the SEC estimates, based on filings with the SEC, that as of December 2001, approximately $6.97 trillion was invested in U.S. mutual funds (including $741 billion invested in open-end management companies that fund variable life insurance and variable annuity contracts, and $23 billion invested in open-end management companies that are exchange-traded funds).

[7] Approximately 1400 of these funds are "series companies" with an aggregate 7200 portfolios. A "series company" is a registered investment company that issues two or more classes or series of preferred or special stock, each of which is preferred over all other classes or series with respect to assets specifically allocated to that class or series. 17 CFR 270.18f-2. The assets allocated to such a class or series are commonly known as a "portfolio." The series or portfolios of a series company operate, for many purposes, as separate investment companies.

A mutual fund is typically governed by a board of directors or trustees, which is responsible for overseeing the management of the fund's business affairs. Mutual funds are typically organized and operated by an investment adviser responsible for the day-to-day operations of the fund. In most cases, the investment adviser is a separate and distinct legal entity from the investment company. The investment adviser is primarily responsible for selecting portfolio investments consistent with the objectives and policies stated in the investment company's prospectus. The investment adviser or a third party may provide administrative services to the fund. Mutual funds also employ transfer agents to conduct recordkeeping and related functions.[8]

A mutual fund offers its shares continuously and is required to provide its shareholders the right to redeem at net asset value on a daily basis.[9] Most mutual funds sell their shares to investors through broker-dealers, banks, and other financial intermediaries.[10] Some funds are sold directly through affiliates of the fund itself. If fund shares are sold through an intermediary, the intermediary may maintain an omnibus account with the fund, in which case neither the fund nor its transfer agent has direct contact with the shareholders. The intermediary receives and processes individual

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[8] Transfer agents maintain records of shareholder accounts, calculate and disburse dividends, and prepare and mail shareholder account statements, federal income tax information, and other shareholder notices. Some transfer agents prepare and mail statements confirming shareholder transactions and account balances, and maintain customer service departments to respond to shareholder inquiries.

[9] Section 5(a) of the Investment Company Act defines an open-end investment company as a management investment company that issues or has outstanding any "redeemable security." 15 U.S.C. 80a-5(a). A redeemable security entitles the holder to receive, upon presentation to the issuer, the holder's approximate proportionate share of the issuer's current net assets, or the cash such share represents. 15 U.S.C. 80a-2(a)(32).

[10] Mutual funds usually offer their shares to the public through a principal underwriter, which is in most cases regulated as a broker-dealer and is subject to rules promulgated by the National Association of Securities Dealers, Inc. With respect to transactions occurring after December 30, 2002, brokers and dealers in securities are required to report suspicious transactions to the Treasury under 31 U.S.C. 5318(g). <u>See</u> 31 CFR 103.19 (suspicious transaction reports by securities brokers or dealers).

investment and redemption requests from its customers, and has access to individuals' trading activity. Although neither the mutual fund nor its transfer agent necessarily knows the identity of individual investors that hold fund shares through a financial intermediary's omnibus account, the intermediary does have access to that information, and may itself have anti-money laundering responsibilities.[11] A foreign broker-dealer without independent anti-money laundering requirements may also maintain omnibus accounts with the fund. This kind of omnibus account falls within the definition of "correspondent account" under section 312 of the Act and as such is subject to due diligence and possibly enhanced due diligence requirements under that section of the Act and implementing regulations.[12]

C. Money Laundering Risks Associated with Mutual Funds

Mutual funds present real opportunities for money laundering. They are widely held, easy to access, and can be redeemed quickly.[13] Indeed, money market funds, which typically offer check writing privileges, function much like bank checking accounts.[14] But because mutual funds rarely receive from or disburse to shareholders significant amounts of currency, they are not as likely as other types of financial institutions (e.g., banks) to be used during the initial (or "placement") stage of the money laundering

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[11] Broker-dealers in securities and futures commission merchants are subject to the anti-money laundering compliance requirements of the Bank Secrecy Act.

[12] Pursuant to section 312, regulations have been proposed that would require U.S. financial institutions offering correspondent accounts to perform due diligence and, in appropriate circumstances, enhanced due diligence on their correspondents. See 67 FR 37736 (May 30, 2002) and 67 FR 48348 (July 23, 2002). [Insert cite to page 9 of the 312 adopting release if that release comes out first.]

[13] Section 22(e) of the Investment Company Act requires a mutual fund to redeem the value of shares within seven days of receiving a redemption request. 15 U.S.C. 80a-22(e).

[14] See Investment Company Act Release No. 17589 (July 17, 1990) [55 FR 30240 (July 25, 1990)].

process.[15] Money laundering is more likely to occur through mutual funds at the later stages of the money laundering process (the "layering" and "integration" stages).[16]

The proposed rule contained in this document is just one of several steps taken by the Department of the Treasury to address comprehensively the risk of money laundering through mutual funds. In April 2002, FinCEN issued an interim final rule requiring mutual funds to develop and implement an anti-money laundering program to prevent them from being used to launder money or finance terrorist activities, which includes achieving and monitoring compliance with the applicable requirements of the Bank Secrecy Act and the Department of the Treasury's implementing regulations.[17] In July 2002, the Department of the Treasury and the SEC jointly issued a proposed regulation to require mutual funds to implement reasonable procedures to (1) verify the identity of any person seeking to open an account, to the extent reasonable and practicable, (2) maintain records of the information used to verify the person's identity, and (3) determine whether

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[15] It is possible that some structuring schemes used in the placement stage will involve monetary instruments such as money orders, and that money launderers could attempt to use mutual funds that accept this form of payment. Although the known experience of depository institutions with significant money laundering is greater than the known experience of mutual funds, this difference may reflect the fact that criminal funds enter mutual funds at a later stage in the laundering process, when those funds are less immediately identifiable than at the placement stage. Past investigative attention, however, has focused more intensively on the "placement" stage of money laundering (especially the suspicious placement into the financial system of large amounts of currency) than on transfers or conversions of illicit funds once they are already in the financial system.

[16] "Layering" involves the distancing of illegal proceeds from their criminal source through the creation of complex layers of financial transactions. Money launderers could use mutual fund accounts to layer their funds by, for example, sending and receiving money and wiring it quickly through several accounts and multiple institutions, or by redeeming fund shares purchased with illegal proceeds and then reinvesting the proceeds received in anther fund. Layering could also involve purchasing funds in the name of a fictitious corporation or an entity designed to conceal the true owners. Mutual funds could also be used to integrate illicit income into legitimate assets. "Integration" occurs when illegal proceeds appear to have been derived from a legitimate source.

[17] See 76 FR 21117 (April 29, 2002).

the person appears on any lists of known or suspected terrorists or terrorist organizations provided to investment companies by any government agency.[18]

This notice of proposed rulemaking follows other recent actions that expand the application of requirements that financial institutions report suspicious transactions. For example, since April 1996, rules issued by FinCEN under the authority contained in 31 U.S.C. 5318(g) have required banks, thrifts, and other banking organizations to report suspicious transactions.[19] In collaboration with FinCEN, the federal bank supervisors concurrently issued suspicious transaction reporting rules under their own authority.[20] The bank supervisory agency rules apply to banks, bank holding companies, and non-depository institution affiliates and subsidiaries of banks and bank holding companies. Money services businesses have been required to report suspicious transactions to the Department of the Treasury since the beginning of 2002. In July 2002, FinCEN took a further step in the creation of a comprehensive system for the reporting of suspicious transactions by the major categories of financial institutions operating in the United States, by requiring brokers and dealers in securities to report suspicious transactions.[21] In October 2002, FinCEN issued a final rule requiring casinos to report suspicious transactions. The proposed rule contained in this document would extend this requirement to mutual funds. Suspicious transaction reporting by mutual funds can

[18] See 67 FR 48318 (July 23, 2002). Under the proposed rule, a mutual fund may contractually delegate the implementation and operation of its customer identification program to a service provider such as a transfer agent although the mutual fund would continue to be responsible for its compliance with applicable requirements.

[19] See 31 CFR 103.18 (requiring banks, thrifts, and other banking organizations to report suspicious transactions).

[20] See 12 CFR 21.11 (issued by the Office of the Comptroller of the Currency); 12 CFR 208.62 (issued by the Board of Governors of the Federal Reserve System); 12 CFR 353.3 (issued by the Federal Deposit Insurance Corporation); 12 CFR 563.180 (issued by the Office of Thrift Supervision); 12 CFR 748.1 (issued by the National Credit Union Administration).

provide highly useful information in law enforcement and regulatory investigations and proceedings, and in the conduct of intelligence activities to protect against international terrorism.[22]

II. Specific Provisions

A. 103.15(a) – Reports by Mutual Funds of Suspicious Transactions

Section 103.15(a) contains the rules setting forth the obligation of mutual funds to report suspicious transactions that are conducted or attempted by, at, or through a mutual fund and involve or aggregate at least $5,000 in funds or other assets. It is important to recognize that the obligation to report a transaction under this rule and 31 U.S.C. 5318(g) would apply whether or not the transaction involves currency.[23] Treasury is aware that the use of currency by mutual funds is rare.

The obligation extends to transactions conducted or attempted by, at, or through, the mutual fund. However, paragraph (a) also contains language designed to encourage the reporting of transactions that appear relevant to violations of law or regulation, even in cases in which the rule does not explicitly so require (for example, in the case of a transaction falling below the $5,000 threshold in the rule).

Section 103.15(a) contains the general statement of the obligation to file reports. To clarify that the proposed rule creates a reporting requirement that is uniform with that for other financial institutions, the language of the reporting obligation incorporates

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[21] See 67 FR 44048 (July 1, 2002).

[22] See 31 U.S.C. 5311 (stating purpose of the reporting authority under the Bank Secrecy Act).

[23] Many currency transactions are not indicative of money laundering or other violations of law, a fact recognized both by Congress, in authorizing reform of the currency transaction reporting system, and by FinCEN, in issuing rules to implement that system (see 31 U.S.C. 5313(d) and 31 CFR 103.22(d), 63 FR 50147 (September 21, 1998)). Many non-currency transactions, (for example, fund transfers) can indicate illicit activity, especially in light of the breadth of the statutes that make money laundering a crime. See 18 U.S.C. 1956 and 1957.

language from the suspicious activity reporting rules applicable to other financial institutions, such as banks, casinos, and money services businesses, requiring the reporting of "any suspicious transaction relevant to a possible violation of law or regulation." Furthermore, a mutual fund may also report "any suspicious transaction that it believes is relevant to a possible violation of any law or regulation but whose reporting is not required" by the proposed rule. For example, a mutual fund may report a suspected violation of law that involves less than $5,000. Such voluntary reporting would be subject to the same protection from liability as mandatory reporting, pursuant to 31 U.S.C. 5318(g)(3).

The proposed rule requires reporting by mutual funds, but not by affiliated persons of mutual funds. Some affiliates, such as broker-dealers, are subject to their own reporting rule. Others may be subject to future rules.

Mutual funds typically conduct many operations through separate entities, which may or may not be affiliated persons of the mutual fund. Personnel of these separate entities may be in the best position to perform the reporting obligation. It is permissible for a mutual fund to contractually delegate performance of the reporting obligation to another affiliated or unaffiliated service provider, such as a transfer agent. The mutual fund, however, remains responsible for assuring compliance with the rule, and must actively monitor the procedures for reporting suspicious transactions.

Section 103.15 (a)(2) specifies that the proposed rule requires the reporting of suspicious transactions that involve or aggregate at least $5,000 in funds or other assets. The suspicious transaction reporting rules, however, are not intended to operate (and indeed cannot properly operate) in a mechanical fashion. Rather, the suspicious transaction reporting requirements are intended to function in such a way as to have financial institutions evaluate customer activity and relationships for money laundering risks.[24]

Section 103.15(a)(2) specifies four categories of transactions that require reporting if the mutual fund knows, suspects, or has reason to suspect that any such category applies to a transaction, or a pattern of transactions of which the transaction is a part. The "knows, suspects, or has reason to suspect" standard incorporates a concept of due diligence in the reporting requirement.

The first category, described in proposed section 103.15(a)(2)(i), includes transactions involving funds derived from illegal activity, or intended or conducted in order to hide or disguise funds derived from such illegal activity as part of a plan to violate or evade any federal law or regulation or to avoid any transaction reporting requirement under federal law or regulation. The second category, described in section 103.15(a)(2)(ii), includes transactions designed, whether through structuring or other means, to evade the requirements of the Bank Secrecy Act. The third category, described in section 103.15(a)(2)(iii), includes transactions that appear to serve no business or apparent lawful purposes, and for which the mutual fund knows of no reasonable explanation after examining the available facts relating to the transaction and the parties. The fourth category, described in section 103.15(a)(2)(iv), includes any other transactions that involve the use of the mutual fund to facilitate criminal activity.[25]

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[24] Thus, for example, transactions involving investments by the pension fund of a publicly traded corporation, even though involving a large dollar amount, would likely require a more limited scrutiny than less typical transactions such as those involving customers who wish to use currency or money orders to purchase mutual fund shares, even though the dollar amounts in those latter cases may be relatively small.

[25] The fourth reporting category has been added to the suspicious activity reporting rules promu lgated since the passage of the USA Patriot Act to make it clear that the requirement to report suspicious activity

A mutual fund must base its determination as to whether a report is required on all the facts and circumstances relating to the transaction and the customer of the mutual fund in question.[26] Different fact patterns will require different types of judgments. In some cases, the facts of the transaction may indicate the need to report. For example, the fact that a customer refuses to provide information necessary for the mutual fund to make reports or keep records required by this Part or other regulations, provides information that the mutual fund determines to be false, or seeks to change or cancel a transaction after such person is informed of information verification or recordkeeping requirements relevant to the transactions, would indicate that a Suspicious Activity Report ("SAR-SF")[27] should be filed.[28] In other situations, determining whether a transaction is suspicious within the meaning of the rule may require a more involved judgment. Transactions that raise the need for such judgment may include, for example, (i) transmission or receipt of funds transfers without normal identifying information, or in a manner that indicates an attempt to disguise or hide the country of origin or destination, or the identity of the customer sending the funds, or the beneficiary to which the funds are sent; or (ii) repeated use of a mutual fund as a temporary resting place for funds from multiple sources without a clear business purpose. The judgments involved will also

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encompasses the reporting of transactions in which legally derived funds are used for criminal activity, such as the financing of terrorism.

[26] In the case of a transaction conducted through an omnibus account maintained by an intermediary, a mutual fund may not know, suspect, or have reason to suspect that the transaction is one for which reporting would be required, because a fund typically has little or no information about individual customers represented in an omnibus account. Omnibus accounts are, however, usually maintained by a person, such as a broker-dealer, that has a reporting obligation. The omnibus account holder (i.e., the financial intermediary) is itself a customer of the mutual fund for purposes of the proposed rule.

[27] The term "SF" is an abbreviation for "Securities and Futures Industry," the form that will be used for reporting by members of the securities and futures industry. See 67 FR 50751 (August 5, 2002).

[28] As section 103.15(d) of the proposed rule makes clear, the mutual fund must not notify the customer that it intends to file or has filed a suspicious transaction report with respect to the customer's activity.

extend to whether the facts and circumstances and the institution's knowledge of its customer provide a reasonable explanation for the transaction that removes it from the suspicious category.

The means of commerce and the techniques of money launderers are continually evolving, and there is no way to provide an exhaustive list of suspicious transactions. FinCEN intends to continue its dialogue with mutual funds about the manner in which a combination of government guidance, training programs, and government-industry information exchange can smooth the way for operation of the new suspicious activity reporting system in as flexible and cost-efficient a way as possible.

Individual mutual funds are frequently part of a complex of related funds, and it is possible that more than one mutual fund would be obligated to report the same transaction. Section 103.15(a)(3) of the proposed rule would permit all of the mutual funds involved in a particular transaction to file a single report as long as the report contains all relevant facts. Moreover, a person such as a broker-dealer that is a service provider to the fund may have a separate suspicious activity reporting obligation with regard to the same transaction. The proposed rule would permit the mutual fund's report to satisfy that person's reporting obligation as well. Thus, a service provider to which multiple mutual funds have contractually delegated their reporting obligation may file a single report on behalf of itself and all of the funds involved in the same transaction or series of transactions.

B. 103.15(b) – Filing Procedures

Section 103.15(b) sets forth the filing procedures to be followed by mutual funds making reports of suspicious transactions. Within 30 days after a mutual fund becomes aware of a suspicious transaction, the fund must report the transaction by completing a SAR-SF, collecting and maintaining supporting documentation, and filing the SAR-SF in a central location, to be determined by FinCEN. The SAR-SF will resemble the SAR used by banks to report suspicious transactions, and a draft form will be made available for comment by publication in the Federal Register.

If the mutual fund does not identify a suspect on the date of the initial detection, the mutual fund may delay filing a SAR-SF for an additional 30 days, but may not delay filing more than 60 days after the date of such initial detection. In situations involving violations that require immediate attention, such as terrorist financing or ongoing money laundering schemes, the mutual fund should telephone the appropriate law enforcement authority and the SEC in addition to filing a SAR-SF.

C. 103.15(c) – Retention of Records

Section 103.15(c) provides that filing mutual funds must maintain copies of SAR-SFs and the original related documentation for a period of five years from the date of filing. As indicated above, supporting documentation is to be made available to FinCEN, the SEC, and other appropriate law enforcement and regulatory authorities on request.

D. 103.15(d) – Confidentiality of Reports

Section 103.15(d) reflects the statutory bar against the disclosure of information filed in, or the fact of filing, a suspicious activity report (whether the report is required by the proposed rule or is filed voluntarily). See 31 U.S.C. 5318(g)(2). Thus, the paragraph specifically prohibits persons filing SAR-SFs from making any disclosure, except to law enforcement and regulatory agencies, about either the reports themselves or supporting documentation.

This paragraph does not prohibit mutual funds from discussing with each other (or with service providers that are involved in the transaction, such as their investment advisers, transfer agents, principal underwriters, and broker-dealers) for purposes of section 103.15(a)(3), suspicious activity involving a transaction with which the mutual funds have been involved, or the determination of which mutual fund will file a SAR-SF in such a case.

E. 103.15(e) – Limitation of Liability

Section 5318(g) of Title 31, as amended by the USA Patriot Act, provides protection from liability for making reports of suspicious transactions, and for failures to disclose the fact of such reporting to persons involved in such transactions. The safe harbor provision of 31 U.S.C. 5318(g) clearly protects any financial institution from civil liability for reporting suspicious activity.[29] Section 351 of the USA Patriot Act clarifies that the safe harbor applies also to the voluntary reporting of suspicious transactions, and section 103.15(e) of the proposed rule reflects this clarification.

It must be noted that, while the proposed rule reiterates and clarifies the broad protection from liability for making reports and for failures to disclose the fact of such reporting that is contained in the statutory safe harbor provision, the regulatory provisions do not extend the scope of either the statutory prohibition or the statutory protection. Inclusion of safe harbor language in the proposal is in no way intended to suggest that the safe harbor can override the non-disclosure provisions of the law and regulations. The prohibition on disclosure (other than as required by the proposed rule) applies regardless of any protection from liability.

F. 103.15(f) – Examinations and Enforcement

Section 103.15(f) notes that the Department of the Treasury or its delegate will examine compliance with the obligation to report suspicious transactions, and provides that failure to comply with the rule may constitute a violation of the Bank Secrecy Act and the Bank Secrecy Act regulations. In examining any particular failure to report a transaction as required by this section, FinCEN and the SEC may take into account the relationship between the particular failure to report and the adequacy of the implementation and operation of a mutual fund's compliance procedures.

G. 103.15(g) – Effective Date

Finally, section 103.15(g) provides that compliance with the new suspicious activity reporting rule would be required by a date 180 days after the date on which the final regulations discussed in this notice of proposed rulemaking are published in the Federal Register.

III. Submission of Comments

FinCEN invites comment on all aspects of the proposed regulation. All comments will be available for public inspection and copying, and no material in any such comments, including the name of any person submitting comments, will be recognized as confidential. Accordingly, material not intended to be disclosed to the public should not be submitted. Comments may be inspected, between 10 a.m. and 4 p.m., in the FinCEN reading room in Washington, DC. Persons wishing to inspect the comments submitted must request an appointment by telephoning (202) 354-6400.

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[29] See Lee v. Bankers Trust Co., 166 F.3d 540, 544 (2nd Cir. 1999) (stating that in enacting 31 U.S.C. 5318(g), Congress "broadly and unambiguously provide[d] ... immunity from any law (except the federal Constitution) for any statement made in a SAR by anyone connected to a financial institution").

IV. Regulatory Flexibility Act

FinCEN certifies that this proposed regulation would not have a significant economic impact on a substantial number of small entities. Investment companies, regardless of their size, are currently subject to the Bank Secrecy Act. Procedures currently in place at mutual funds to comply with existing Bank Secrecy Act rules should help mutual funds to identify suspicious transactions. In addition, the limited use of currency to purchase mutual fund shares will likely reduce the number of suspicious activity reports required to be filed. Finally, certain small mutual funds may have an established and limited customer base whose transactions are well known to the fund.

V. Executive Order 12866

The Department of the Treasury has determined that this proposed rule is not a significant regulatory action under Executive Order 12866.

VI. Unfunded Mandates Act of 1995 Statement

Section 202 of the Unfunded Mandates Reform Act of 1995, Public Law 104-4 (Unfunded Mandates Act), March 22, 1995, requires that an agency prepare a budgetary impact statement before promulgating a rule that includes a federal mandate that may result in expenditure by state, local, and tribal governments, in the aggregate, or by the private sector, of $100 million or more in any one year. If a budgetary impact statement is required, section 202 of the Unfunded Mandates Act also requires an agency to identify and consider a reasonable number of regulatory alternatives before promulgating a rule. FinCEN has determined that it is not required to prepare a written statement under section 202 and has concluded that on balance this proposal provides the most cost-effective and least burdensome alternative to achieve the objectives of the rule.

VII. Paperwork Reduction Act

The collection of information contained in this proposed rule is being submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent (preferably by fax (202-395-6974)) to Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Office of Management and Budget, Paperwork Reduction Project (1506), Washington, DC 20503 (or by the Internet to jlackeyj@omb.eop.gov), with a copy to FinCEN by mail or the Internet at the addresses previously specified. Comments on the collection of information should be received by [INSERT DATE THAT IS 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]. In accordance with the requirements of the Paperwork Reduction Act of 1995, 44 U.S.C. 3506(c)(2)(A), and its implementing regulations, 5 CFR 1320, the following information is presented to assist those persons wishing to comment on the information collection.

FinCEN anticipates that this proposed rule, if adopted as proposed, would result in the annual filing of a total of 3,000 suspicious activity reports by mutual funds. This result is an estimate based on the estimated number of respondents under the rule.

Description of Respondents: Mutual funds as defined in 31 CFR 103.15(a).

Estimated Number of Respondents: 3,000.

Frequency: As required.

Estimate of Burden: The reporting burden of 31 CFR 103.15 will be reflected in the burden of the form used by mutual funds to report suspicious transactions. The recordkeeping burden of 31 CFR 103.15 is estimated as an average of 3 hours per form, which includes internal review of records to determine whether the activity requires reporting.

Estimated Total Annual Recordkeeping Burden: 9,000 hours.

FinCEN specifically invites comments on: (a) whether the proposed recordkeeping requirement is necessary for the proper performance of the mission of FinCEN, and whether the information shall have practical utility; (b) the accuracy of FinCEN's estimate of the burden of the proposed recordkeeping requirement; (c) ways to enhance the quality, utility, and clarity of the information required to be maintained; (d) ways to minimize the burden of the recordkeeping requirement, including through the use of automated collection techniques or other forms of information technology; and (e) estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to maintain the information.

In addition the Paperwork Reduction Act of 1995 requires agencies to estimate the total annual cost burden to respondents or recordkeepers resulting from the collection of information. Thus, FinCEN also specifically requests comments to assist with this estimate. In connection with this, FinCEN requests commenters to identify any additional costs associated with the completion of the form. These comments on costs should be divided into two parts: (1) any additional costs associated with reporting; and (2) any additional costs associated with recordkeeping.

List of Subjects in 31 CFR Part 103

Administrative practice and procedure, Authority delegations (Government agencies), Securities, Currency, Investigations, Law enforcement, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

1. The authority citation for part 103 continues to read as follows:

Authority: 12 U.S.C. 1829b and 1951-1959; 31 U.S.C. 5311-5314 and 5316-5332; title III, secs. 312, 313, 314, 319, 352, Pub. L. 107-56, 115 Stat. 307.

2. In Subpart B, redesignating § 103.15 as § 103.12.

3. In Subpart B, add new § 103.15 to read as follows:

§ 103.15 Reports by mutual funds of suspicious transactions.

(a) General. (1) Every investment company (as defined in section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a-2) ("Investment Company Act") that is an open-end company (as defined in section 5 of the Investment Company Act (15 U.S.C. 80a-5)) and that is registered, or is required to register, with the Securities and Exchange Commission pursuant to that Act (for purposes of this section, a "mutual fund"), shall file with FinCEN, to the extent and in the manner required by this section, a report of any suspicious transaction relevant to a possible violation of law or regulation. A mutual fund may also file with FinCEN a report of any suspicious transaction that it believes is relevant to the possible violation of any law or regulation but whose reporting is not required by this section. Filing a report of a suspicious transaction does not relieve a mutual fund from the responsibility of complying with any other reporting requirements imposed by the Securities and Exchange Commission.

(2) A transaction requires reporting under the terms of this section if it is conducted or attempted by, at, or through a mutual fund, it involves or aggregates funds or other assets of at least $5,000, and the mutual fund knows, suspects, or has reason to suspect that the transaction (or a pattern of transactions of which the transaction is a part):

(i) Involves funds derived from illegal activity or is intended or conducted in order to hide or disguise funds or assets derived from illegal activity (including, without limitation, the ownership, nature, source, location, or control of such funds or assets) as part of a plan to violate or evade any federal law or regulation or to avoid any transaction reporting requirement under federal law or regulation;

(ii) Is designed, whether through structuring or other means, to evade any requirements of this part or any other regulations promulgated under the Bank Secrecy Act, Public Law 91-508, as amended, codified at 12 U.S.C. 1829b, 12 U.S.C. 1951-1959, and 31 U.S.C. 5311-5314, 5316-5332;

(iii) Has no business or apparent lawful purpose or is not the sort in which the particular customer would normally be expected to engage, and the mutual fund knows of no reasonable explanation for the transaction after examining the available facts, including the background and possible purpose of the transaction; or

(iv) Involves use of the mutual fund to facilitate criminal activity.

(3) The obligation to identify and properly and timely to report a suspicious transaction rests with each mutual fund involved in the transaction, provided that no more than one report is required to be filed by the mutual funds involved in a particular transaction or any other person obligated to report the transaction, so long as the report filed contains all relevant facts.

(b) <u>Filing procedures</u> – (1) <u>What to file</u>. A suspicious transaction shall be reported by completing a Suspicious Activity Report – Investment Companies ("SAR-SF"), and collecting and maintaining supporting documentation as required by paragraph (c) of this section.

(2) Where to file. The SAR-SF shall be filed with FinCEN in a central location, to be determined by FinCEN as indicated in the instructions to the SAR-SF.

(3) When to file. A SAR-SF shall be filed no later than 30 calendar days after the date of the initial detection by the reporting mutual fund of facts that may constitute a basis for filing a SAR-SF under this section. If no suspect is identified on the date of such initial detection, a mutual fund may delay filing a SAR-SF for an additional 30 calendar days to identify a suspect, but in no case shall reporting be delayed more than 60 calendar days after the date of such initial detection. In situations involving violations that require immediate attention, such as terrorist financing or ongoing money laundering schemes, mutual funds are encouraged to immediately notify by telephone an appropriate law enforcement authority in addition to filing timely a SAR-SF. Mutual funds wishing voluntarily to report suspicious transactions that may relate to terrorist activity may call FinCEN's Financial Institutions Hotline at 1-866-556-3974 in addition to filing timely a SAR-SF if required by this section. The mutual fund may also, but is not required to, contact the Securities and Exchange Commission to report in such situations.

(c) Retention of records. A mutual fund shall maintain a copy of any SAR-SF filed and the original (or business record equivalent) of any supporting documentation for a period of five years from the date of filing the SAR-SF. Supporting documentation shall be identified as such and maintained by the mutual fund, and shall be deemed to have been filed with the SAR-SF. The mutual fund shall make all supporting documentation available to FinCEN, any other appropriate law enforcement agencies, or federal or state securities regulators upon request.

(d) Confidentiality of reports. No mutual fund, and no director, officer, employee, or agent of any mutual fund, who reports a suspicious transaction under this part, may notify any person involved in the transaction that the transaction has been reported, except to the extent permitted by paragraph (a)(3) of this section. Thus, any person subpoenaed or otherwise required to disclose a SAR-SF or the information contained in a SAR-SF, except where such disclosure is requested by FinCEN, the Securities and Exchange Commission, or another appropriate law enforcement or regulatory agency, shall decline to produce the SAR-SF or to provide any information that would disclose that a SAR-SF has been prepared or filed, citing this paragraph (d) and 31 U.S.C. 5318(g)(2), and shall notify FinCEN of any such request and its response thereto.

(e) Limitation of liability. A mutual fund, and any director, trustee, officer, employee, or agent of any mutual fund, who makes a report of any possible violation of law or regulation pursuant to this section or any other authority (whether such report is required or is made voluntarily) shall not be liable to any person under any law or regulation of the United States (or otherwise to the extent also provided in 31 U.S.C. 5318(g)(3)) for any disclosure contained in, or for failure to disclose the fact of, such report.

(f) Examinations and enforcement. Compliance with this section shall be examined by the Department of the Treasury, through FinCEN or its delegees, under the terms of the Bank Secrecy Act. Failure to satisfy the requirements of this section may constitute a violation of the reporting rules of the Bank Secrecy Act and of this part.

(g) Effective date. This section applies to transactions occurring 180 days after the date on which the final regulations discussed in this notice of proposed rulemaking are published in the Federal Register.

Dated: ______________________________

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James F. Sloan

Director,

Financial Crimes Enforcement Network